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Before the

FEDERAL COMMUNICATIONS COMMISSION

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SBC AND AMERITECH	)	

THE IMPACT OF TELEPHONE COMPANY MEGAMERGERS ON THE PROSPECTS FOR COMPETITION IN LOCAL MARKETS

COMMENTS OF

THE CONSUMER FEDERATION OF AMERICA

And

CONSUMERS UNION

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SUMMARY

The Consumer Federation of America (CFA) and Consumers Union (CU) believe that the SBC/Ameritech (SBC/AIT) merger is contrary to the public interest and should not be allowed to close. This merger is different from previous local exchange company mergers that have been approved by the Commission.

- The impact on the national market structure is larger and it creates unique regional problems.

- The monopoly over local service has proven much more resistant to change than Congress anticipated primarily because the merging parties have retarded competition at every turn. SBC has a particularly bad record on local competition and it will be calling the shots should the merger proceed.

The merger violates the Department of Justice's merger guidelines by a wide margin. When markets have too few players, the public policy presumption is that competition will not be sustainable.

Consumers lose actual and potential competition in local telephone markets as a result of the merger. Ameritech had begun to compete in St. Louis for SBC's customers; it won't anymore. The most likely competitor for local service is another local company with expertise in the industry and facilities nearby. This option is lost up and down the mid-West.

Despite the Congress's promises and the FCC's vigorous efforts, the incumbent local exchange companies have actively blocked competitors by charging excessive rates for access to their local networks, delaying delivery of services to those customers who do switch local phone service and by often failing to negotiate disputes with competitors. To date competitors have taken less than one percent of the market from the Bells. Claims that easy entry will discipline the market power of the merged incumbents are ludicrous.

The greater the market power at the regional and national level the less the likelihood that competitors will break through in the local market. The vast geographic scope of the company and unmatched financial resources will make it more difficult for competitors to enter local markets.

The greater the market power at the regional and national level the greater the likelihood that market power will be extended into related industries. When companies get to be so big that they account for a huge share of the national market they gain the ability to make or break services or dictate what will be offered by controlling access to their customers. These companies have already begun to try to do this in their joint marketing arrangement for long distance service (Ameritech) and their high speed Internet backbone development (SBC and Ameritech).

I. THE OVERALL IMPACT OF THE MERGERS

A. THE ISSUE BEFORE REGULATORS AND POLICYMAKERS

Evaluation of the proposed mergers between huge local exchange companies must take into account the history of merger policy and activity since the passage of the Telecommunications Act of 1996 (the 1996 Act). In this context, the analysis of industry structure can be posed as two interrelated questions that must be answered. First, are these mergers sufficiently different from earlier telecommunications mergers to require them to be stopped, when others have been approved?

The Consumer Federation of America (CFA) and Consumers Union (CU) believe that the SBC/Ameritech (SBC/AIT) merger is different and should not be allowed to close.[1] The differences are

- the order of magnitude of the impact on the national market structure,
- the unique regional problem that these mergers pose,
- the continuing monopoly in local markets, and
- the disappointing experience with the introduction of competition.

The second question emerges immediately from the first. If these companies already have a monopoly at the local level, what difference does it make if they gain regional domination

[1] CFA/CU vigorously opposed the Bell Atlantic – NYNEX merger (see "Direct Testimony of Dr. Mark N. Cooper on Behalf of New York Citizens Utility Board, The Consumer Federation of America, The American Association of Retired Persons, and Citizen Action of New York," before the State of New York Public Service Commission, Case No. 96-C-0603 and 96-C-0599, November 25, 1996.

or that the national market devolves into a very tight national oligopoly made up of essentially two, 55 million line companies and a number of smaller companies?

We believe that it makes a big difference.

- The greater the market power at the regional and national level the less the likelihood that competitors will break through in the local market.
- The greater the market power at the regional and national level the greater the likelihood that market power will be extended into related industries.

These mergers would result in a market structure that is simply too concentrated to support effective competition. For the purposes of this discussion, we include an analysis of the independent and combined effects of the two megamergers. There are two reasons we discuss both mergers.

First, the nation will be deeply affected by each merger. Second, it is also critical for regulators at the federal and state levels to begin to take a comprehensive view of the emerging structure of the telecommunications industry.[2] The continuation of a deal-by-deal, piecemeal

[2] The Federal Communications Commission recognized the emerging problem in the piecemeal approval of mergers. In Memorandum Opinion and Order, File No. NSD-L-96-10 (released August 14, 1997). The FCC warned:

> Granting this application subject to conditions does not mean applicants will always be able to propose pro-competitive public interest commitments that will offset potential harm to competition. Nor would these particular conditions necessarily justify approval of another proposed merger for which applicants had not otherwise carried their burden of proof. Different cases will present different facts and competitive circumstances. As competitive concerns increase, it becomes significantly more difficult for applicants to carry their burden to show that the proposed transaction is in the public interest. A merger that in the relevant markets eliminated a competitor with even greater assets and capabilities then Bell Atlantic would present even greater competitive concerns. For some potential mergers, the harm to competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies. In such cases, we would not anticipate the applicants could carry their burden to show the transaction, even with commitments, is pro-competitive and therefore in the public interest.
>
> We also note that we are concerned about the impact of the declining number of large incumbent LECs, on this Commission's ability to carry out properly its responsibilities to

view will allow the industry to slip into a thoroughly anticompetitive structure with no overarching consideration of the cumulative effect of individual deals on the prospect for competition.

B. MARKET CONCENTRATION

The size and scope of the mergers would have a dramatic impact on the overall market structure. Each of these mergers exceeds the Department of Justice's Merger Guidelines. Taken together, they absolutely fracture the guidelines. Adding these merges atop the prior mergers would create an industry structure that must be a source of grave concern to policy makers and regulators.

1. CONCEPTUALIZING THE PROBLEM OF MEASURING MARKET POWER

The issue in market structure analysis is to identify situation in which a small number of firms control a sufficiently large part of the market as to make coordinated or reinforcing activities feasible. Through various implicit and explicit mechanisms, when there are a small

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ensure just and reasonable rates, to constrain market power in the absence of competition, and to ensure the fair development of competition that can lead to deregulation. During the transition to competition it is critical that the Commission be able effectively to establish and enforce its pro-competitive rules and policies. As diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices. We often rely, for example, on cross-carrier comparisons as strong evidence as to technical feasibility or reasonableness. The Bell Companies, being of similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance. Reducing the number of Bell Companies makes it easier to coordinate actions among them, and increases the relative weight of each company's actions on average performance. Because we approve this merger with conditions, thereby reducing the number of independently controlled large incumbent LECs, future applicants bear an additional burden in establishing that a proposed merger will, on balance, be pro-competitive and therefore serve the public interest, convenience and necessity.

number of firms they can reinforce each other's behavior, rather than compete. Identification of exactly where a small number of firms can exercise this power is not a precise science. Generally, however, when the number of significant firms falls into the single digits, there is cause for concern, as the following suggests.

> Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.[3]

The clear danger of a market with a structure equivalent to only six equal sized firms was recognized by the Department of Justice in its Merger Guidelines.[4] These guidelines were defined in terms of the Herfindahl-Hirschman Index (HHI). This measure takes the market share of each firm squares it, sums the result and multiplies by 10,000.

A market with six equal sized firms would have a HHI of 1667. The Department declared any market with an HHI above 1800 to be highly concentrated. Thus, the key threshold is at about the equivalent of six of fewer firms.

Another way that economists look at a market at this level of concentration is to consider the market share of the largest four firms (4-Firm concentration ratio). In a market with six equal sized firms, the 4-Firm concentration would be 67 percent. The reason that this is considered an

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3 J. W. Friedman, Oligopoly Theory (Cambridge: Cambridge University Press, 1983), pp. 8-9.

4 U.S. Department of Justice, Merger Guideline, revised, 1992.

oligopoly is that with that small a number of firms controlling that large a market share, their ability to avoid competing with each other is clear.

Shepherd describes this threshold as follows:[5]

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

While six is a clear danger sign, theoretical and empirical evidence indicates that one must have many more firms than six to be confident that competition will prevail -- perhaps as many as fifty. Reflecting this basic observation, the Department of Justice established a second threshold to identify a moderately concentrated market. This market was defined by an HHI of 1000, which is equivalent to a market made up of 10 equal sized firms. In this market, the 4-Firm concentration ratio would be 40 percent.

Shepherd describes this threshold as follows:

> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.[6]

Even the moderately concentrated threshold of the Merger Guidelines barely begins to move down the danger zone of concentration from 6 to 50 equal sized firms. For a "commodity" with the importance of telecommunications, certainly this moderately concentrated standard is a more appropriate place to focus in assessing the structure of the market. In other words, in simple economic markets levels of concentration typified by 10 equal sized firms are high enough to raise questions about the competitive behaviors of the firms in the market. Given the nature of the telecommunications industry and the special concern about the free flow of ideas, this is a conservative level of concentration about which to be concerned.

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[5] W. G. Shepherd, The Economics of Industrial Organization (Englewood Cliffs: Prentice Hall, 1985), p. 4.

2. THE IMPACT OF THE PENDING MERGERS ON MARKET STRUCTURE

On a national scale, at the time of the passage of the Telecommunications Act of 1996, the industry was just above the level that the Department of Justice defines as moderately concentrated.[7] The HHI was about 1200. Thus, by the conceptual definition, there was little likelihood that the firms could affect price, but the level of concentration was sufficient to be a source of some concern.

The mergers that have been approved since the Telecommunications Act of 1996 have increased that concentration about by 300 points. This brings the industry to approximately 1500. This moves it past the mid-point of the range that is considered to be moderately concentrated.

The pending mergers have a much larger impact on the national market. Each of the major mergers that have been proposed would increase the HHI by approximately 500 points. Either of the mergers would drive the concentration into the range of 2000 well into the highly concentrated range. Clearly, these mergers are different than the previous mergers.

Taken together, they would put the market at 2500. At this level of concentration, the industry would be a major source of concern. If these mergers are approved, we will have

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6 Shepherd, p. 4.

7 For the purposes of this analysis, we use the local exchange and exchange access market as a distinct telecommunications market. There is absolutely no doubt that this is a distinct market. The distinction is deeply embedded in public policy under the Telecommunications Act of 1996, as well as economic reality. The Department of Justice analyzes this as a distinct market in its section 271 evaluations (see Affidavit of Marius Schwartz, Competitive Implications of Bell Operating Company Entry into Long-Distance Telecommunications Service," May 14, 1997. This paper demonstrates why concentration of national and regional ownership of local exchange and exchange access assets matters as a matter of public policy. SBC's claim that it will pursue a national local strategy only serves to prove the point that these local assets should be considered from a national and regional market structure perspective.

experienced a remarkable and troubling transformation in the local telecommunications market structure in less that three years. We will have moved from an industry structure whose concentration was roughly equivalent to eight equal-sized competitors, which is generally considered to be effectively competitive, to one whose concentration is roughly equivalent to four equal-sized competitors, which is generally considered to be a tight oligopoly and quite vulnerable to abuse of market power.

The market concentration analysis presented in this section leads us to conclude that these mergers would not be in the public interest. Market concentration, as measured by the HHI, is only one way to look at the mergers. There are other ways, but these lead to the same conclusion, as discussed in the next section.

II. THE FAILURE OF LOCAL COMPETITION SINCE THE PASSAGE OF THE TELECOMMUNICATIONS ACT OF 1996

Although formal market concentration analysis is crucial as the starting point for assessing the impact of mergers, other considerations should enter the deliberation process. Factors such as ease of entry, or alternative regulatory protections can be cited to "soften" the conclusion that these mergers are anticompetitive on the basis of market concentration analysis. At the same time, factors such as regional domination (akin to fortress hubs in the airline industry), barriers to entry, or past behavior can be cited "strengthen that conclusion. On balance, the factors arguing that these mergers will be bad for the public far outweigh those that suggest they would be in the public interest.

A. THE FAILURE OF LOCAL COMPETITION

One of the considerations that regulatory authorities can take into account in moving beyond the formulaic calculation of concentration ratios in analyzing mergers is the ease of entry into the industry. If it can be argued that entry barriers are low, even high levels of concentration may not indicate anticompetitive impacts are likely to flow from a merger. Regulators across the nation can find no comfort on this score in reviewing these mergers.

Although the legal barriers to local competition were removed in principle by the 1996 Act, there continue to be numerous administrative, technical and economic barriers to competition. The severe difficulty of introducing local competition under the 1996 Act and the clear pattern of preventing local competition from taking root in which these companies have engaged indicates that ease of entry cannot be counted as a factor that mitigates the conclusion based on the concentration measures. These are steadfast local monopolists who are proposing mergers that would result in a tight oligopoly at the national level.

If past conduct is any indicator of the prospects for local competition, these companies fail that test too. Individually and collectively they have thrown every barrier imaginable in the way of competition.

The Telecom Act's fundamental premise that breaking down legal barriers to market entry would unleash a barrage of facilities-based competition in which cable companies used their plant to attack the local phone market and local phone companies used their networks to attack cable has proven wrong. Nation-wide, facilities-based competitors for local telephone service have taken less than one percent of the business market. Facilities-based competition is virtually non-existent in the residential sector.

Of course, Congress understood that it would take a long time to build competing facilities so it opened less ambitious paths to market entry. Congress demanded that new entrants be allowed to use existing bottleneck facilities at cost-based, nondiscriminatory rates, terms and conditions. These have been thoroughly frustrated by the refusal of the incumbents to cooperate and tied up in courts and in administrative proceedings. The result is that these approaches have failed to break the local telephone monopoly. Even including resale, with the exception of a few major urban areas where competitors have two or three percent of local business customers, incumbents still have a 99 percent market share in the business sector, and almost 100 percent for residential ratepayers.

The threat of entry by alternative technologies has also failed to materialize. In local telephone markets, wireless remains between five and ten times more expensive for the average residential customer. "One-wire" integrated cable-telephone networks have proven too expensive and unworkable.

B. THE PROBLEM OF EXPANDING THE CONTROL OF A COMPANY THAT IS HOSTILE TO LOCAL COMPETITION

The merger will complicate the process of introducing competition in the Ameritech region. The merger could significantly set back competition. There are two problems. First, SBC has been a very difficult party to deal with in regard to the opening of local markets. Second, SBC will probably change the Ameritech systems. This will set the whole process back.

SBC has waged a vigorous war against the competitive conditions that Congress laid down for entry by the Regional Bell Operating Companies (RBOCs) into long distance within their regions. While SBC complains about section 271 as being a special punishment inflicted on the RBOCs, virtually all of its regulatory and legal disputes have been over the implementation of the section 251, 252 and 253, conditions which were imposed on all local exchange companies (LECs).

Extensive cases in Texas, California and Oklahoma have documented the deep seeded problem in SBC's approach to local competition. Table 1 makes the point that SBC has been uncooperative. The cause of the failure of local competition can be found in the campaign of obstruction, foot dragging, and refusal to cooperate conducted by SBC since the very passage of the Act.

TABLE 1
SPECIFIC AREAS WHERE SBC
FAILS TO MEET REQUIREMENTS FOR ENTRY INTO
IN REGION LONG DISTANCE

NON-COMPLIANCE PROBLEMS	CHECK LIST ITEM	SPECIFIC ACTS AND POLICIES	CITATION STATE/WITNESS
VIOLATION OF COURT RULINGS, CONTRACT TERMS AND COMMISSION ORDERS	ii	Failure to provide non-facilities-based recombination	ALL
	ii	Refusal to provide recombined elements as agreed	ALL
	ii	Refusal to file a collocation tariff as ordered	TX Was
	ii	Refusal to charge an agreed upon per order charge	TX Bur
	xiii	Refusal to pay reciprocal compensation for ISP traffic	ALL
	Xiii	Refusal to negotiate reciprocal compensation	CAL Brk
	Xiv	Refusal to make individual contracts available for resale	OK Whi
FINAL-COST BASED RATES ARE NOT IN EFFECT	i, ii	Rates are interim	CAL OK
	ii	UNEs, subject to court challenge	ALL
	ii	Non-recurring charges are not cost-based	ALL
	ii	Network element prices are not cost-based	ALL
	xiii	Reciprocal compensation subject to court challenge	TX
	xiv	Resale discounts subject to court challenge	TX
COLLOCATION DISCRIMINATION	ii	Excessive charges	ALL
	ii	Discriminatory ownership conditions	TX Lan
	Ii	Discriminatory operating conditions	TX Was
	ii	Failure to define collocation procedures	All
	ii	Failure to document lack of space	CAL ALL
FAILURE TO PROVIDE 14 POINTS ON CONDITIONS THAT ARE NOT DISCRIMINATORY	i	Interconnection: refusal to allow combined use of facilities	TX F/K
	i	Failure to load codes	ALL
	i	Refusal to provide NNI	ALL TCG
	i	Refusal to provide calling area information	TX Pel
	i	Failure to meet standards	CAL ALL
	Ii	Refusal to treat UNE/facilities-based entrants in a non-discriminatory	ALL Far, NEXT SPRNT
	ii	RTU claims and procedures are discriminatory	TX OK W
	ii	Refusal to provide digital loops	ALL
	iii	Discriminatory access to ROW, etc.	CAL ALL
	v	Refusal to provide dedicated transport	TX OK Ma, Kal
	v	Failure to demonstrate routing of calls	ALL
	vi	Refusal to provide intraLATA access as part of UNE use	TX F/K
	vi	Refusal to provide customized routing	TX OK Ma
	vii	Discriminatory 911, DA, OS	TX OK Ma, Hug
	viii	Discriminatory white pages	ALL
	ix	Discriminatory number administration	ALL
	x	Refusal to provide Access	CAL TCG
	xi	Discriminatory number portability	ALL
	xii	Failure to demonstrate intraLATA dialing parity	ALL

	xiii	Refusal to treat CLEC as other ILECs are treated with the imposition of toll charges	TX OK G Bur Was
	xiii	Discriminatory Compensation	CAL MCI
	xiv	Discriminatory resale	ALL
	xiv	Change authorization is discriminatory	CAL TX MCI LAN
OSS PERFORMANCE IS NOT AT PARITY	all	Multiple entry , Incomplete editing capability, Manual processing especially for UNEs, Complex Orders, Error rectification by fax, Customer Service Records by mail, Information verification by telephone, Billing information incomplete Incomplete verification FOC delay Service interruption	}ALL
	all	inability of OSS to perform at full commercial availability	ALL
PERFORMANCE MEASURE DEFICIENCIES	all	Refusal to provide individual measures for each CLEC	TX OK P
		Refusal to provide measures of SWBT subsidiary	TX OK_Wes
		Failure to meet parity for even a restricted set of reported measures	ALL
		Lack of penalties	TX OK
		Failure to provide adequate measures	ALL
		Failure to provide measures for different categories of services	TX OK
ABUSE OF AFFILIATE RELATIONS	n/a	Failure to establish a 272 affiliate	ALL MCI CR
		Refusal to report performance measures for affiliate	
		Delivery of internal OSS to pay-phone affiliate.	TX OK Bur
ANTI-COMPETITIVE MARKETING	n/a	Penalties for customer contract termination	OK Cad
		Abuse of switching customers	Mc, Cad
		Win-Back Program	CAL LCI
		Abuse of CPNI	CAL SPRNT

SOURCES AND NOTES:

Underlined entries do not constitute disputes, rather they are "official" positions of Southwestern Bell Telephone Company which violate the Telecommunications Act of 1996 as interpreted by the Department of Justice and the Federal Communications Commission and clearly provide grounds for denial of the application for entry into in-region long distance

Non-underlined entries represent disputes that are of sufficient importance and documentation that, if left unresolved, would provide grounds for denial of the application for entry into in-region long distance.

The designation ALL. means that the issue has arisen in California and at least one other SBC state and has been raised by at least three companies.

Otherwise, the citations are as follows with companies and witnesses identified for Texas and Oklahoma and companies only identified for California (based on responses to Commission questions).

LEGEND FOR CITATIONS

OKLAHOMA AND TEXAS

AT&T --	B=BARNES, C= CONNELLY, CR= CROMBIE, D= DALTON, F= FLAPPAN, F/K = FALCONE AND KRABILL, G= GADDY, L= LANCASTER, P=PFAU, T= TURNER, W= WICHTER,
MCI --	BA= BAROS, MA= MARTINEZ,
ACSI --	KAL=KALLENBACH,
SPRINT --	STA=STAHLY, WES=WESTCOTT

TEXAS ONLY

DIG --	DIGITAL NETWORK SERVICES
TCG --	FAR= FAROUH, MOU=MOUNT-CAMPBELL, PEL= PELLETEIR, WAS=WASHINGTON
TEXALTEL --	BET=BETHANCOURT, BUC= BUCKLEY, LAN= LAND
TISPA	KIS
USLD --	BAL= BALDWIN, BUR = BURKE
WESTTEL	ROW

OKLAHOMA ONLY

ACSI --	WHI= WHITE
BROOKS --	CAD= CADIEUX, HUG=HUGMAN
WESTERN --	NEW= NEWSOME

CALIFORNIA

The company names are used.

There are about fifty issues that demonstrate this pattern of behavior on the part of SBC. These include

- Violation of court rulings, contract terms and commission orders;

- Failure to make services available on a permanent basis at cost-based rates;
- Failure to make the 14 points on the competitive checklist available at nondiscriminatory rates, terms and conditions;
- Failure to provide OSS at parity with performance measurement proposals that cannot ensure parity;
- Failure to institute the required safeguards for its long distance affiliate;
- Engaging in anti-competitive marketing practices in the local market.

Several examples underscore the extent of the problem. These involve not simply disputes between potential competitors and SBC, but SBC actions that seek to undermine the authority of regulators. One example involves the refusal of SBC to comply with the Texas Public Utility Commission in regard to collocation tariffs.

> SWBT was ordered to provide physical and virtual collocation arrangements in Texas pursuant to a tariff. Texas Arbitration Award, Nov. 8, 1996 at para 13. Texas is the only state within SWBT's five-state area where such a tariff is required. Having SWBT's proposed rates, terms, and conditions for physical collocation subjected to the review of the Commission resulted in terms, conditions, and rates that will be more favorable for competitive entry within the five-state area.
>
> The Commission is aware, however, of the process that AT&T, MCI, and Teleport Communications Group (TCG) and the Arbitrators had to go through to achieve the final result of physical collocation tariff that was approved by the Commission on March 10, 1998. SWBT was ordered to file and revise its proposed physical collocation tariff three different times. See, Texas Arbitration Awards, Nov. 8, 1996 at Para. 13; Sept. 30, 1997 at 5, Dec. 19, 1997 at 6. The Commissioners even required the Commission Staff to complete the tariff because of SWBT's failure to include provisions that complied with the Arbitration

Awards. See Open Meeting Transcript (February 25, 1998), Chairman Pat Wood, at 190-191. The Staff complete the approved the Physical Collocation Tariff on March 9, 1998.a/

a/ Indeed, even after the Commission approved the Tariff in Order No. 33, SWBT submitted a subsequent proposed physical collocation tariff in which it incorporated modifications to the tariff. See SWBT's Submission of Revised Physical Collocation Tariff Filed on March 27, 1998. AT&T was not privy to discussions regarding SWBT's proposed modification, nor has AT&T had time to assess the impact of the changes. AT&T is in the process of determining the nature of each change. But, the filing is indicative of SWBT's apparent disregard for the importance of the tariff and its affect AT&T and other CLECs ("Affidavit of Larry D. Barnes on Behalf of AT&T Communications of the Southwest, Inc.," Investigation of Southwestern Bell Telephone Company's Entry into the InterLATA Telecommunications Market, Public Utility Commission of Texas, Project No. 16251, April 1, 1998, pp. 11-12).

Having refused to file the tariff and battled for over two years, the key elements of the Texas Commissions order were challenged in court. Although the Court has ruled against SBC, the intransigence has had the inevitable effect of delaying competition.

Another example involves the entire section 271 process. After invoking section 271 before the MFJ court in an attempt to recover documents in the possession of the court as a result of the antitrust case; after citing section 271 in seeking a change in its certificate of public convenience and necessity in Oklahoma, SBC sought to have it declared unconstitutional. Ironically, while the challenge was precipitated by the application that was filed in Oklahoma, SBC chose a federal court in Texas to sue, so the court ruling was not even binding in Oklahoma, since a lower court ruling outside of the state is not binding in Oklahoma. It did not provide grounds for altering the CCN. SBC was seeking a more friendly court in an out of state jurisdiction.

As difficult as SBC is dealing with commissions, it is no easier to deal with in private negotiations.

Time Warner's interconnect agreement with SWBT achieved its primary purpose: it's provided a means for Time Warner to quickly enter the Texas market. But SWBT's inflexible and restrictive interpretations of the contract do not allow a consistently cooperative relationship between the parties. During its negotiations SWBT assured me personally, time and time again, that even though it could not contractually agree to certain provisions proposed by Time Warner, many of the concerns we had would be addressed in the normal course of business. Unfortunately, this has not been the case. When I need SWBT's assistance and cooperation to resolve the issues that regularly arise, the most common response I get from SWBT is "Is it provided for in our interconnection agreement?" The second most common is "We have to check with the policy folks. "

We are coming up on the two-year anniversary of interconnecting with SWBT. I had [hoped] we would be farther along than this. Time Warner manages many contracts, both with customers and with other carriers, including other RBOCs. None have been as fraught with disagreement and inflexibility as the SWBT/Time Warner interconnection agreement.

The employees I work with at SWBT are professional and courteous. Many I consider friends. However, there is a clear unwillingness to cooperate on any issues that are outside SWBT's vision of the local market. Even in cases where it appeared SWBT was willing to work with Time Warner on an issue not addressed in the contract, it has been SWBT's corporate position that an amendment must be made and approved before it can be implements. It is expensive to implement changes in this manner and the time frames involved do not allow Time Warner to meet customer demand due dates...

The implications of several contract provisions were unknown at the time the parties agreement was drafted and Time Warner is planning to amend such provisions. For example, Time Warner was adamant in its position that it not be confined to the same service area as SWBT and this is clearly provided for in section 5.1.1. However, SWBT recently referred me to a Section 9.1, which it believes contradicts and prohibits what is expressly provided in section 5.1.1. I am in the process of researching earlier drafts of the agreement to determine when the language was added and for what purpose. Section 9.1 is a provision that the parties did not spend significant time on and no one on the Time Warner interconnection team recalls agreeing to or even discussing the provision ("Affidavit of Kelsi Reeves on Behalf of Time Warner Communications, Inc.," Investigation of Southwestern Bell Telephone Company's Entry into the InterLATA Telecommunications Market, Public Utility Commission of Texas, Project No. 16251, April 1, 1998, pp. 11-12).

In a somewhat more ominous vein, the Texas proceeding witnessed a heated debate over a telephone call that the Chairman of SBC made to Ernst and Young after it was revealed that Ernst and Young was working with AT&T to implement an electronic interface. Shortly after the telephone call, Ernst and Young withdrew from its contract with AT&T.

Even if one were to assume that SBC would behave no better or worse that AIT with regard to local competition, there is an inherent problem in changing corporate ownership at this time. Changing policies and processes will delay competition.

SBC must lower Ameritech's operating costs by exploiting economies of scale. One must assume that it will do so by using SBC systems. Competitors will have to change. This will disrupt the process of opening the local markets. The change in California had this effect.

> A good example of how the control of proprietary systems documentation can frustrate a new entrant's efforts is alluded to in the affidavit of Elizabeth A. Ham. Throughout 1997, Pacific Telesis failed to meet its commitment to provide Sprint with its EDI specifications for resale and UNE ordering. Following the acquisition of Pacific Telesis by SBC, Pacific attributed its inability to provide EDI documentation to an effort to merge Pacific Telesis and Southwestern Bell's EDI specification. Consequently, Sprint was led to believe that a new, single set of EDI ordering specifications would be forthcoming to complete the partial EDI documentation Sprint had previously received. Both Pacific Telesis and SWBT provided a variety of documents related to EDI to Sprint in 1997. Indicative of the degree of confusion following the SBC/Pacific Telesis acquisition, in September 1997, the SWBT account manager attempted to fulfill Sprint's request for EDI ordering specifications by providing SWBT's EDI 811 billing transaction documentation, a topic wholly unrelated to the requested specifications for resale and UNE ordering. Sprint did not receive a complete, current, coherent set of Southwestern Bell EDI documentation for ordering resale services and UNEs until November 1997 ("Direct Testimony of Paul Westcott on Behalf of Sprint Communications Company L.P.," Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market, Project No. 16251, March 31, 1998, p. 19).

SBC is also likely to change policies. This will disrupt the business plans of competitors. This was the effect in California, as one company pointed out.

> MCI first applied for physical collocation space at SBC/Pacific's Anaheim office in April of 1997. SBC/Pacific denied MCI's application, claiming there was insufficient space at that facility...
>
> Following SBC/Pacific's denial of its application for physical collocation, MCI applied for a virtual collocation at Anaheim 01 in June of 1997. MCI included in its application details of the equipment it proposed to purchase and install. SBC/Pacific rejected MCI's application as "incomplete" because it lacked "appropriate pages" and an original signature page, and required MCI to submit an entirely new application. In August, MCI submitted a new application for virtual collocation. SBC/Pacific did not respond with a cost quote for this application until October, and its quote included the cost of equipment that SBC/Pacific knew had already been purchased by MCI.
>
> MCI objected to paying SBC/Pacific to purchase equipment MCI had already bought for this collocation, but SBC/Pacific responded that it was the policy of the new parent company, SBC, to buy virtual collocation equipment itself because of "legal concerns." SBC/Pacific was unwilling to consider a $1 leaseback arrangement frequently employed by other BOCs. Instead, SBC/Pacific took the position that MCI was stuck with idle equipment (Response of MCI Telecommunications Corporation (U 5011C) and MCI Metro Access Transmission Services, Inc. (U 5253C) to Questions in Appendix Be to Joint Managing Commissioner's and Administrative Law Judge's Ruling, Dated February 20, 1998, March 31, 1998).

Third, SBC's policy on its section 272 affiliate is troubling. SBC takes the position that it can establish an unregulated affiliate to prepare for entry into long distance and then, on the day of approval, transform that affiliate into a regulated subsidiary. It claims that it will comply with the law at the time it accepts the legal obligation to do so (after it gains entry) and that it has voluntarily complied with the law before entry. SBC's practices are in blatant violation of the structural safeguards required by the Act.

- The board and officers are also employees of the parent and therefore it is hard to believe that they are independent.

- The subsidiary is purchasing services from the parent in the areas in which these officers have responsibilities in the parent.

- The details of the transactions have not been reported.

- Terms and conditions have been constantly changing so it is impossible to know which terms have applied to which actual transactions (which have not yet been reported).

- The affiliate has been provided services on rates, terms and conditions that are not available to competitors (e.g. access to SORDES for order processing, multiple lines per order).

- Records were being kept in the wrong place.

The Commissions in California and Texas have recently found SBC to be grossly deficient in its implementation of the Telecommunications Act of 1996. The Texas and California Commissions found that SBC had failed to meet the vast majority of the 14 points on the checklist. Texas found that SBC was uncooperative and made 129 recommendations for SBC and opened a collaborative. With the opening of the collaborative, SBC continued its intransigent attitude. As the Texas Office of Public Utility Counsel noted

> The Texas Office of Public Utility Counsel (OPC) commends the Commission for writing a well-reasoned recommendation in Southwestern Bell Telephone Company's section 271 proceeding that will promote competition and protect the public interest. That order identifies 129 steps that SWBT must take in order to open its local market. The order proposes a collaborative process to deal with difficult problems that have been unresolved for over two years. After solutions are worked out, SWBT implements them effectively and permanently, and gives competition a chance to take hold in Texas, OPC believes that the Commission, the Department of Justice (DOJ) and the Federal Communications Commission (FCC) will be able to find that the local market has been irreversibly opened to competition.
>
> Unfortunately, this is not what SWBT plans to do. It still has not gotten the message. It has refused to implement about 10 percent of the recommendations of the Commission and it has tried to take 75 percent of the recommendations off the table by deciding by fiat what it will do. In its opinion, only about one out of

> eight of the Commission's recommendations is the proper substance of a collaborative.
>
> SWBT asserts that this is an opportunity. OPC agrees. It is an historic opportunity to define a market structure that irreversibly opens one of the last utility monopolies to competition. OPC disagrees about how to seize the opportunity, however. A rush to judgement, as SWBT advocates, would replicate the mistakes of Michigan, Oklahoma, South Carolina, and Louisiana and result in a blunt denial by the DOJ and the FCC of a premature application for entry into in-region interLATA long distance. Texas deserves better. The Commission has laid down a road map that will succeed. It should stay the course and require SWBT to travel the difficult road to competition.[8]

Developments in California have taken a similar tack. Recent reports in both collaboratives show that SBC is far from having open markets.

C. THE LOSS OF A LIKELY COMPETITOR

It must also be said that the merger of these two companies denies ratepayers of a potential competitor. Non-incumbent local telephone companies with expertise, assets deployed nearby, centralized functions that could support local competition should have been the most likely candidates to compete with incumbents.

Incumbent local exchange companies have deployed strategic investments -- investments in excess of the needs of its own local service -- which would be easily used to support entry into each other's territory. They have the appropriate expertise and the available resources to fund entry into competitor's service territories. They obviously believe that they can achieve economies of scale by entry, they just prefer to buy more customers rather than compete for

[8] "Comments Of The Texas Office Of Public Utility Counsel In Reply To Southwestern Bell Telephone Company's Initial Filing In The Collaborative Process, Before The Public Utility Commission Of Texas Investigation Of Southwestern Bell Telephone Company's Entry Into The interLATA Telecommunications Market, Project No. 16251, June 21, 1998, p. 1

them. The services which they sell in their home markets and which could be provided in competitive markets include the full gamut of telecommunications and information services.

Ironically, Bell Atlantic, one of the companies most directly involved in the merger wave in the telecommunications industry, described these unique resources that incumbent local exchange companies possess. Its own statements support the notion that the loss of a local exchange company as a potential competitor is a serious setback for competition. In attempting to convince the Department of Justice that it should be allowed to merge with TCI, Bell Atlantic argued that a local exchange partner was indispensable for competition to develop in local telephone service. [9]

> In short, go-it-alone undertakings by telephone and cable companies simply do not begin with adequate technical expertise and other resources to challenge dominant, well-established incumbents. Cable/telco alliances are therefore essential to these companies' effective entry into another's business (Request at 11, emphasis added).

Bell Atlantic claims that without the expertise and resources of a BOC even the nations largest cable operator could not go into the telephone business.

> On their own, cable operators lack the expertise in telephone technology and service that will be a critical factor in any attempt to compete effectively with the incumbent telco. That is why alliances between cable operators and telephone companies from other regions, like the Bell Atlantic/TCI/Liberty merger, are the best opportunity in the short term for real competition against incumbent LECs" (Becker, at 5 emphasis added).

[9]Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company, Civil No. 82-0192 (HHG) January 20, 1994. The request consists of six parts, the request itself and five affidavits (Affidavits in Support of Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport , January 20, 1994. Individual affidavits include Alfred E. Kahn and William E. Taylor (hereafter Kahn and Taylor); Gary S. Becker (hereafter Becker); Robert W. Crandall (hereafter Crandall); Robert G. Harris (hereafter Harris); and Brian D. Oliver (hereafter Oliver).

Bell Atlantic has painted a bleak picture of the difficulty of cable entry into the local telephone business. The following is the list of technical and organizational obstacles to cable entry that Bell Atlantic put before the Department of Justice.

> In addition to this fundamental architectural problem, cable systems lack a number of other capabilities for providing local telephone service.
>
> a. Most fundamentally, cable systems lack the sophisticated switching systems necessary to route telephone traffic on a call-by-call basis among subscribers or between subscribers and carriers.
>
> b. Cable systems also lack the specialized billing systems needed to handle multiple services and large volumes of individually metered transactions.
>
> c. The provision of local telephone service also requires specialized operations Support Systems to hand facilities provisioning, administration and maintenance, traffic management, service evaluation, and the planning and engineering associated with switched services. While customers might tolerate loss of television service for several hours or more, they demand virtually fault-free telephone service. *
>
> d. The provision of local telephone services also requires a series of technical and economic arrangements for routing of telephone traffic between and among local cable systems, the incumbent local service provider, wireless systems and long distance carriers.
>
> e. Finally, cable companies typically do not have the radio engineering skills needed to provide telephone services using wireless technology.
>
> */ Operating Support Systems normally include extensive record-keeping systems for lines and trunks, automated trouble reporting systems, signal network controls and administration, long-range facilities and switching capacity planning systems, alarm surveillance systems, a variety of equipment tracking and inventory systems, centralized switching and transmission systems, and control and monitoring systems" (Oliver at 4,5,6).

We find it ironic that SBC had to buy Ameritech (or Ameritech had to be bought by SBC) in order to gain an interest in competing in other cities. In fact, SBC should have been particularly keen to attack Ameritech's markets, since Ameritech had actually moved to enter some of SBC's markets, at least on a resale basis.

While it is theoretically and economically correct to say that the nation loses a competitor because SBC and Ameritech are no long available to attack each other's markets and Bell Atlantic and GTE would not be available to compete with each other, it also should be said that the incumbent LECs have shown little stomach for real competition. Since the passage of the Telecommunications Act these companies have not only made it virtually impossible for new entrants to compete within their territories, they have refused to attack the service territories of their sister companies. Only Ameritech had been certified to compete in a number of states. It was, however, restricting itself to resale competition.

The SBC/AIT claim that this is somehow the final ingredient that will finish the recipe for local competition should be taken as the grain of salt that it is. There is no legal, economic, or technical reason why a company must rise to a market share of one-third before it can be moved to compete outside of its service territory. There is no reason why a company which has shown no inclination whatsoever to compete, should be suddenly transformed into a vigorous competitor once it becomes a dominant firm. Quite the opposite is likely, as we have seen in California as a result of the SBC/PACTel merger. The promise of future competition is an elaborate ruse intended to distract regulators from the clearly anticompetitive effects of the merger during the approval process.

Because we are dubious about the commitment of these companies to compete under any circumstances, we believe the major damage to competition comes from the substantial reinforcement to barriers to entry that would result from the merger that were discussed above and the hostility of the new parent company to local competition, which is discussed in the next section.

III. REGIONAL MONOPOLIES AND MARKET POWER IN NETWORK INDUSTRIES

A. THE REGIONAL DEPLOYMENT AND STRATEGIC USE OF THE MERGED ASSETS

The analysis of national market concentration does not fully reflect the impact of these mergers on market structure. The mergers would create two 50+ million-line companies with highly concentrated regional monopolies at the heart of a tight national oligopoly. SCB/AIT would have approximately 55 million lines in the contiguous area from Ohio to Texas. GTE/BA would have approximately 55 million lines in the contiguous area from Maine on the North to North Carolina on the South to Ohio and Indiana on the West. The remaining landline market is only 60 million lines and these are much more scattered around the country (Bell South, US West and the other independents).

This deployment of assets gives the merging companies an immense advantage in the local market. The other companies in the industry lack these two fundamental characteristics. That is, they have virtually no assets deployed to serve local markets. They have virtually no loops and no central office facilities. To the extent that they have telecommunications assets deployed, they are spread around all fifty states. Thus, not only would each of the companies control about one-third of the national market, but also one quarter of the assets they control would be concentrated in a regionally dominant position. The mergers create end-to-end networks that give the incumbents a decided advantage if they are allowed to enter the long distance or other lines of business. The merged companies can capture traffic internally, whereas competitors have much less ability to do so.

This regional domination is an added element of the economies of scale and scope the companies will enjoy. It is quite clear that the merging parties intend to capture economies of scale and scope with this combination of assets. Scale economies will result from sheer size. Scope economies result from the ability to provide end to end service. Competitors cannot match these advantages.

B. LEVERAGING MARKET POWER INTO OTHER MARKETS?

Because the market power on the supply-side of the point of sale is reinforced by a low elasticity of demand the ability of incumbent telephone monopolists to leverage their market power is considerable.

This means that consumer resistance to price increases or bundling is limited. The low elasticity of demand for basic network access can also be leveraged to attack other markets. Distribution has become so highly concentrated at the regional and national scale that a successful launch of new services may come to require the implicit consent and support of the major national players. Bundling and packaging of services can be used to foreclose demand. An independent content provider cannot get in front of enough eyeballs or talk to enough computers to make a go of it without access to the dominant systems.

The increasingly large regional telephone monopolies have begun to show how they will leverage this market power. They have begun to try to control the success of upstream entities be leveraging their monopoly at the point of sale and favoring integrated firms. They have tried to do this in their joint marketing arrangement for long distance service in which they give an advantage to one supplier over others. Similarly, in seeking to have their high-speed networks declared not to be common carriage networks, they hope to gain an ability to choose the Internet service providers who will have access to their huge base of subscribers.

Independent content providers, who are not affiliated with the dominant local/regional monopolist, have little ability or incentive to compete on price since they do not have an alternative outlet. They may as well pay the excess to the distribution monopolist and tap into the larger market.

C. ENTRENCHMENT OF MARKET POWER HURTS CONSUMERS

The continuing lack of competition and the concentration and integration in the industry have created perverse pricing policies. Facilities-based competitors in the telephone industry have argued for higher prices, rather than lower, in order to create margins for their new facilities. The use of bottleneck facilities has come at price levels advocated by local companies that protect their monopoly rates. Downward pressures on residential local rates are non-existent. Independent firms in markets that rely on the local distribution plant are willing to enter these arrangements because they are better off becoming the favored supplier in a joint venture, rather than compete, because the relationship with the incumbent conveys such a large advantage.

The bottom line impact on consumers of these entrenched monopolies is prices that are vastly inflated over competitive levels. Rather than enjoying the price reductions that consumers were promised, there have been significant upward pressures on rates, under the rubric of "rate rebalancing." Regulators have also found it convenient to shift costs onto residential ratepayers by adding surcharges to the bottom of the bill.

For the reasons given above, the FCC should prevent the merger from going forward by refusing to grant the requested transfers of licenses.